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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

LEONARD NOBELMAN and HARRIET NOBELMAN,

Petitioners,

v.

AMERICAN SAVINGS BANK,

Respondent.

On Writ of Certiorari to the United States
Court of Appeals for the Fifth Circuit

BRIEF OF AMICI CURIAE NATIONAL ASSOCIATION OF REALTORS® AND THE CALIFORNIA ASSOCIATION OF REALTORS® IN SUPPORT OF RESPONDENT

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INTEREST OF AMICI

The NATIONAL ASSOCIATION OF REALTORS® [1] ("NAR") is a not-for-profit professional association com-

* All parties of record in this case have consented pursuant to Supreme Court Rule 36.1 to the filing of this *amicus curiae* brief in support of Respondent. These consents are filed herewith.

[1] The term "REALTORS®" is a federally registered collective membership mark used to identify members of the NATIONAL ASSOCIATION OF REALTORS®.

prised of approximately 750,000 persons engaged in all aspects of the real estate business.

NAR was created in 1908 to protect and promote private ownership of real property, to promote and encourage the highest and best use of land, and to advance professional competence in the rendition of real estate services. Through its many programs and the programs of its affiliated Institutes, Societies and Councils, NAR has been involved in matters of concern to home owners and other property owners for over three quarters of this century.

A member of NAR, the California Association of REALTORS® ("CAR") is a voluntary trade association whose members consist of local Boards of REALTORS® in California and those persons licensed by the state of California as real estate brokers and salespersons who are members of local Boards. There are 180 Boards of REALTORS® and over 120,000 individual members affiliated with CAR. CAR's mission is to serve its members by developing and promoting programs and services to enhance their ability to conduct their individual real estate businesses successfully, with integrity and competence.

NAR is the nation's largest trade association serving the real estate industry and CAR is the largest state trade association serving the real estate industry. As such, Amici and their members are greatly concerned with the interconnected matters of the availability and affordability of home ownership for as many Americans as possible. The decision in this case will have a significant impact on both availability and affordability of home ownership. Accordingly, Amici believe that they are uniquely positioned to recognize the seriousness of the threat to home ownership that would be posed by permitting the bifurcation of liens secured by the principal residences of debtors functioning under Chapter 13 of the Bankruptcy Code into a secured

portion equal to the market value of the residence and an unsecured portion equal to the balance of the indebtedness.

The reaction of lending institutions to such bifurcations will undoubtedly result in a decrease in the supply of responsible, affordable home mortgage financing; create a paucity in the availability of residential housing; dramatically curtail residential real estate transactions; and severely threaten the ability of many Americans to own their own homes. These are the inevitable products of permitting debtors functioning under Chapter 13 of the Bankruptcy Code to bifurcate a mortgage lien secured by their principal residence into secured and unsecured portions, and Amici strongly urge this Court to affirm the decision of the court below.

Amici do not propose to duplicate the legal arguments presented in the Respondent's brief. Rather, Amici endorse and urge to this Court the Statement of the Case and legal arguments set forth in that brief. Amici's intent in submitting this brief *amicus curiae*, is to add to the chorus of parties urging this Court to affirm the decision of the court below the voices of the hundreds of thousands of members of Amici and the Americans they serve, millions of current home owners as well as millions of Americans who hope that someday they too, will be able to participate in the American Dream by owning their own homes.

SUMMARY OF ARGUMENT

A significant negative impact on the availability of responsible, affordable home mortgage financing is the inevitable result should this Court allow the Petitioners to bifurcate the mortgage lien secured by their principal resi-

dence into a secured portion equal to the market value of the residence and an unsecured portion equal to the balance of the indebtedness (also referred to as a "cramdown"). Permitting cramdowns most likely would result in immediate, direct and serious losses to home mortgage lending institutions and would produce a correspondingly negative effect on the willingness of such lenders to finance future home mortgage loans. The severe repercussions for the entire real estate industry and for Americans who hope to purchase homes are obvious.

Cramdowns also would contravene the plain meaning of Section 1322(b)(2) of the Bankruptcy Code, which clearly protects mortgage lenders holding a lien secured by the debtor's principal residence from a bifurcation such as that proposed by the Petitioners. The plain language of §1322(b)(2) expressly states that the rights of lenders which are secured by things other than real property which is the debtor's principal residence may be modified and that the rights of home mortgage lenders are exempt from such modification. This means that the rights of holders of liens secured by items such as a vacation home or personal property may be modified. Cramdowns also would contravene the legislative intent underlying §1322(b)(2), namely, to offer special protection to home mortgage lenders under Chapter 13, in contrast to other types of creditors such as consumer loan creditors.

The purported conflict between §1322(b)(2) and §506(a) of the Bankruptcy Code is easily reconciled. The definition of a "claim" is set forth in §101(5)(A), which is part of the definitional section of the Bankruptcy Code. The definitions contained in that section apply to the rest of the Bankruptcy Code. It does not make sense to attempt to understand §1322(b)(2), especially its use of the word "claim", without reference to the definitional portion of the Code.

Cramdowns would have negative implications for the entire residential real estate industry and the hundreds of thousands of Americans who depend upon this vibrant industry for their livelihood, as well as all of the Americans who hope someday to participate in the American Dream of home ownership.

ARGUMENT

I.

CHAPTER 13 DEBTORS SHOULD NOT RECEIVE A WINDFALL AT THE EXPENSE OF THEIR LENDER AND FUTURE BORROWERS.

This case raises the question of whether debtors in a Chapter 13 bankruptcy case may bifurcate a lien secured by real property which is their principal residence into a secured portion equal to the then current market value of their residence and an unsecured portion for the balance of the indebtedness. This proposed bifurcation is commonly referred to as a "cramdown".

A particularly troubling aspect of mortgage cramdowns is that they do not provide a mechanism to address appreciation in the market value of the real property subsequent to the bifurcation of the lien. For example, where a Chapter 13 cramdown has been allowed and the real estate market subsequently improves, only the debtor benefits from the increased value of the residence. There is no way for the lienholder, whose lien has been bifurcated so that it is only secured up to an amount equal to the then current market value of the real property, to benefit from the appreciation of the property. Such a windfall to the debtor is both unfair and wholly at odds with the spirit

of Chapter 13 of the Bankruptcy Code. By enacting Chapter 13, Congress intended to improve creditor recoveries as well as debtor relief. *Collier on Bankruptcy* (15th edition) §1330.02.

Why should the debtor reap a benefit from bankruptcy that it otherwise would not enjoy? If a cramdown has been allowed, the lender already has been penalized once. Why should the lender be penalized yet again by the debtor receiving all of the benefits of an increase in the value of the residence while the lender, who made it possible for the debtor to purchase the home in the first place, is prevented from receiving any of the benefit from the increased value of the property?

Moreover, not only would it be the lenders unlucky enough to find themselves involved in Chapter 13 cramdowns which would be penalized by Chapter 13 debtors' receipt of windfalls; such windfalls would be at the expense of other potential home purchasers who will be penalized by the response of lenders to cramdowns in general by stiffening their lending requirements and increasing the costs associated with borrowing funds.

II.

SECTION 1322(b)(2) AND BANKRUPTCY POLICY IN GENERAL DO NOT MIMIC THE EFFECT OF FORECLOSURE, NOR SHOULD THEY.

One of the arguments advanced by the Petitioners in this case is that §1322(b)(2) replicates the effect of foreclosure. It is clear that the plain meaning of §1322(b)(2), which sets forth what a debtors' Chapter 13 Plan may contain, does not dictate or suggest the replication of the effect of foreclosure in Chapter 13 situations. The fallacy of Petitioners' position is that, if cramdowns are permitted

under §1322(b)(2), such modifications would *not* place the lender in the same position it would have been in had foreclosure taken place.

What this faulty analysis fails to take into consideration is that in many foreclosure situations, the lender recoups more than merely the amount realized from the sale of the real property, which amount often is much less than the amount due the lender pursuant to the loan. Frequently home mortgage lenders' losses due to foreclosures are reduced through insurance payments and the payment of postforeclosure claims. Polk, *The Chapter 13 Cramdown: New Nightmare for the Lender*, 19 *Real Estate Law Journal* 279, 292 (1991). The Petitioners' contention that the lender would be in an advantageous situation following a cramdown, or even in a situation comparable to that following foreclosure, is not convincing because it does not reflect what actually occurs in the marketplace.

If one were to accept the Petitioners' premise on this point, and if §1322(b)(2) were construed to replicate the effect of foreclosure, then in addition to holding a secured interest in the residence equal to its market value, the lender also should receive an amount equal to the insurance proceeds and any other payments it would have received had a foreclosure occurred. To do otherwise, and provide the lender with a security interest only equal to the market value of the property, unfairly would place the lender in a much less desirable position than it would have been in following a foreclosure.

Additionally, there is no principled reason to fashion bankruptcy policy merely to mimic the effect of foreclosure. A far better practice, and one in keeping with the spirit of Chapter 13, would be to provide for an exchange of benefits. This is because the debtor is permitted to retain

the residence, (and, incidentally, benefit from any post-bankruptcy appreciation in the value of the house, as discussed above) and the lender (which provided the funds to enable the debtor to purchase the home in the first place), ought to be permitted to retain its security interest in the home for the full amount of the loan. In this manner, the lender only would be able to benefit from its security interest in the real property if and when the debtor recovers from his or her financial difficulties or the real estate market recovers sufficiently to allow the lender to recover a greater portion of the loan amount through foreclosure.

III.

THE PROPER CONSTRUCTION OF AND CONGRESSIONAL INTENT UNDERLYING §1322(b)(2) ALSO REJECTS ALLOWING CRAMDOWNS.

Amici believe that an appropriate statutory analysis of §1322(b)(2) leads inescapably to the result that cramdowns are not intended in Chapter 13 of the Bankruptcy Code, as explained below.

A. The Plain Meaning of §1322(b)(2) of the Bankruptcy Code Prohibits Debtors From Modifying the Rights of Lenders Which Are Secured Only by Their Principal Residence.

Since *Nobelman v. American Savings Bank* is a Chapter 13 case, it is logical to begin with an examination of the portion of Chapter 13 itself, §1322(b)(2), which is applicable to this situation. On its face, §1322(b)(2) plainly and unequivocally forbids a Chapter 13 debtor from modifying the rights of lenders which are secured only by a mortgage lien on the real property which is the debtor's

principal residence. This is consistent with and advances Congress' intent to offer home mortgage lenders special protection in Chapter 13 cases.

The protection offered home mortgage lenders under Chapter 13 not only benefits lenders which find themselves involved with debtors who have filed for reorganizations under Chapter 13, but, as will be more fully explained later in this brief, the special protection §1322(b)(2) extends to home mortgage lenders benefits the entire residential real estate industry and potential home buyers. Home lenders require protection from the serious financial losses which inevitably would occur if cramdowns are permitted in Chapter 13 situations. Preservation of the affordability and availability of home mortgage financing, and consequently, the ability of consumers to purchase homes, likewise is virtually dependent on sound protection.

The Petitioners advance the notion that the protection afforded home mortgage lenders pursuant to §1322(b)(2) is limited by §506(a) of the Bankruptcy Code and a "secured claim" as described therein. Erroneously interpreting §1322(b)(2) in this manner, they claim that a lender's security interest in the residence should be reduced to an amount equal to the then current market value of the property. Amici urge the Court to note that it is only very recently that anyone has even questioned, much less suggested attacking, the protection so clearly afforded home mortgage lenders in §1322(b)(2).

The Petitioners' claim relies on the unfounded assumption that the words "secured claims" and the words "claim secured only by a security interest in real property" as used in §1322(b)(2), possess the same meaning. According to the plain language of §1322(b)(2), this assumption simply is not valid; these two non-identical phrases do not have

identical meanings. To interpret them as if they mean the same thing would remove from §1322(b)(2) the extremely important distinction it makes between claims which are secured **only** by the debtor's principal residence and those claims which are secured by items other than the debtor's principal residence.

To achieve this significant distinction, §1322(b)(2) employs the words "claim secured only by a security interest in real property . . ." (referred to as the "other than" clause) to limit the clause immediately preceding it. Thus, the "other than" clause explains that while the rights of a holder of a secured claim which is not secured by the debtor's principal residence may be modified, the rights of a holder of a claim for which the only security is the debtor's principal residence may **not** be modified. Unquestionably this means that the rights of holders of claims secured by something other than the debtor's principal residence, such as a vacation home or personal property, may be modified through the debtor's Chapter 13 plan. The purpose of the "other than" clause is straightforward; to explain that a lender's rights may not be modified by the debtor's Chapter 13 plan when the lender's only form of security is the debtor's principal residence.

The Petitioners' assumptions with regard to the interpretation of these clauses of §1322(b)(2) overlooks a basic common sense premise of statutory construction, namely, when interpreting the meaning of a word contained in a statute, one consults the definitional section of the statute for the meaning of the word. Section 101 is the definitional section of the Bankruptcy Code, and Section 103(a) of the Bankruptcy Code states that the definitions contained in Chapter 1 apply to cases under Chapter 13. Therefore, §101(5) provides the definition of the word "claim" for Chapter 13.

The relevant portion of §101(5) is as follows: " 'claim' means—(A) right to payment, whether or not such right is . . . secured or unsecured;". It is obvious from this definition that the word "claim" as used in §1322(b)(2) means both secured and unsecured claims. *See In re Etchin*, 128 B.R. 662, 667 (Bankr. W.D. Wisc. 1991). Accordingly, it is apparent that the operative word of the "other than" clause is the word "only".

The first clause of §1322(b)(2) articulates the concept that secured claims which are secured by property other than the debtor's principal residence may be modified. Once the definition of "claim" as set forth in the definitional section of the Bankruptcy Code is consulted, the next clause of §1322(b)(2), the "other than" clause, explicitly states that the rights of holders of secured or unsecured claims, the basis for the interest of which is the debtor's residence, may not be modified.

B. The Legislative History of §1322(b)(2) and Congressional Policy Regarding Home Mortgages are Consistent With the Position That Cramdowns Should Not Be Permitted In Chapter 13 Cases.

Where the meaning of a statute is not clear, it is proper to take policy considerations into account to assist in the interpretation of the statute. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737, 95 S.Ct. 1917, 1926 (1975) and *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 109 S.Ct. 1026, 1031 (1989). In its enactment of §1322(b)(2), Congress obviously intended to offer home mortgage lenders special protection from cramdowns. Congress overwhelmingly has encouraged affordable and readily available home mortgage financing, as demonstrated by Congress' establishment of effective programs through which the federal government guarantees home mortgages,

and by the establishment of an active secondary mortgage market.

For example, Congress established both the Federal Housing Administration and the VA Home Loan Guaranty Program to insure home mortgage financing made available through private lending institutions. Through both of these successful programs, Congress has enabled many Americans to obtain mortgage financing and purchase homes with very small down payments. To fulfill Congress' objective to make home mortgage financing available to as many Americans as possible, the Petitioners' strained construction of §1322(b)(2) to permit cramdowns must be rejected.

Under both of these programs, in order for a lender to recover on a defaulted loan, the lender first must liquidate the mortgage. If cramdowns are allowed in Chapter 13 cases, most likely the government only would guarantee payment on the secured amounts as reduced through the bifurcation. Lenders obviously would need to protect themselves from such reductions in governmental guarantees, and they almost certainly would do so by increasing the amount of down payments they require. This would thwart the Congressional purpose underlying the provision of governmental guarantees in the first place, namely making home financing and therefore, home ownership, available to as many Americans as possible.

The stability of the secondary mortgage market is an additional concern. Thanks to the secondary mortgage market and mortgage-backed securities, more Americans are able to obtain home financing with rates and on terms that approach those available to corporate entities. If cramdowns are permitted, payments on the underlying mortgages over the life of the loans would be decreased and the secondary mortgage and mortgage-backed security

markets would be threatened seriously. As a result, Congressional intent would be frustrated and the American consumer would suffer.

Further revealing Congressional intent with respect to Chapter 13 and the protection afforded home mortgage lenders thereunder is a discussion with respect to Chapter 12 and farm reorganizations. In a discussion regarding what may be accomplished in a plan, Congress stated "What may be in a plan comes from both Chapter 13 and Chapter 11. In Chapter 13 a debtor may not modify the mortgage on his residence (§1322(b)(2))—that provision was omitted and the debtor would be able to rearrange his home mortgage in Chapter 12 just as he can in Chapter 11." 132 Cong. Rec. §5448 (Wednesday, May 7, 1986).

IV.

PERMITTING BIFURCATIONS UNDER CHAPTER 13 OF THE BANKRUPTCY CODE WOULD HAVE SERIOUS NEGATIVE IMPLICATIONS FOR FUTURE RESIDENTIAL REAL ESTATE FINANCING AND FOR THE ENTIRE REAL ESTATE INDUSTRY AS WELL AS PRECLUDE MANY FINANCIALLY RESPONSIBLE AMERICANS FROM OWNING THEIR OWN HOMES.

If this Court allows the cramdown proposed by the Petitioners in this case, other similarly situated debtors would be encouraged to seek such modifications of the loans secured by their residences. Such a decision might even encourage more individuals to file for reorganization under Chapter 13 of the Bankruptcy Code. Ever increasing numbers of individuals already are filing for such reorganizations. Even during the relatively strong economic times of the late 1980's, the number of bankruptcy filings continued to increase, and as the stigma attached to filing for bankruptcy continues to disappear, it is only logical

to assume that even greater numbers of individuals will seek bankruptcy protection. Polk, at 280. Amazingly, in 1989, one out of every 138 American households was in bankruptcy. *Id.*

Permitting cramdowns under Chapter 13 would cause home mortgage lending institutions to suffer immediate, direct and serious losses. Understandably, this would produce a correspondingly negative effect on the willingness of such lenders to finance future home mortgage loans and to refinance existing home mortgage loans. This reluctance most likely would be felt to the greatest degree in those parts of the nation where the market values of homes are expected to continue to decline and where the economy is expected to continue to languish. Lenders in those parts of the country understandably would feel particularly susceptible to Chapter 13 bankruptcy filings, cramdowns and the resulting losses inherent in cramdowns. The response of lending institutions to cramdowns will impact most severely potential home buyers on the margin of mortgage lending requirements. Lenders would be unwilling to supply mortgage financing to numerous individuals who would qualify for financing today.

In addition, permitting cramdowns could result in serious negative implications for American consumers in general as well as for the residential real estate industry and the hundreds of thousands of Americans who depend upon that industry for their livelihood. The potential threats to consumers include a decrease in the availability of home mortgage loans and increased costs associated with such loans in the form of higher interest rates, larger down payment requirements and increased application fees. Thus, many Americans who qualify for a loan will find it nevertheless more expensive to own their own home. Many other individuals could be precluded from selling their existing homes (already a difficult proposition in much of the country) as potential purchasers become unable to obtain affordable mortgage financing; still other individuals could be prevented from refinancing their homes.

CONCLUSION

Permitting cramdowns under Chapter 13 of the Bankruptcy Code would have serious negative implications for future residential real estate financing and therefore, for the residential real estate industry as well as for Americans who hope to purchase homes. Section 1322(b)(2) clearly exempts home mortgage lenders from cramdowns, and the intention of Congress is to encourage affordable and readily available home mortgage financing by protecting home mortgage lenders through the enactment of §1322(b)(2). Amici urge this Court to give vitality to Congress' objective by prohibiting Chapter 13 cramdowns.

Respectfully submitted,

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